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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner

v.

C. GORDON ANDERSON, TRUSTEE

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF

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REPLY BRIEF

Introduction

This reply brief, unlike our initial brief on the merits ("C. Br.") makes no attempt at unified topical presentation, and consists largely of a gloss of annotations on specific passages in the trustee's brief ("T. Br.") and in the brief filed for Messrs. Shaffer and Spitzer, the successor mortgagees on the Caplan mortgage ("S-S. Br."). We shall deal primarily with a few points of fact that we think the trustee and Shaffer-Spitzer have treated less than informatively in their briefing.

We shall not try to grab back from them every straw at which they have snatched. At that, some of our comments may seem to the Court, as they do to us, perhaps too obvious to be worth making, or on points too farfetched in the responding briefs to be worth answering. But we cannot permit conceptions of style and elegance in briefing to risk leaving the case in confusion if reference to what we said in our brief or what the evidence says in the record, may serve to unconfuse. Our opponents' frequent use of matter that is neither the subject of judicial notice nor part of the record lodged here with the petition for certiorari, however, requires initial comment.

On-the-record and off-the-record evidence

We have no objection to the Shaffer-Spitzer brief passages which quote material from testimony and orders that we know actually appeared on the original district court record, e.g. S-S.Br.6,9-10,35 ff., notwithstanding the formality of lodgment with the Clerk of this Court has not been complied with. We have used similar material, set out infra, p.A 1-23, certified copies lodged with the Clerk. Nor do we especially object on the ground of off-the-record to the trustee's use of 1965 and 1966 earnings figures (T.Br.45 n.21). Although not served on the parties these figures were at least filed in the district court and could therefore be similarly certified. We cannot, however, agree to the use of such figures, when presented without the benefit of the cross examination that exposed the trustee's willful downward distortion of his earlier earnings figures, commented on C.Br.47-50.

We do object most seriously, however, to the trustee's repeated reference to documents which never achieved record status at all. Thus he says of certain of his private labors on the Merrill-Stevens claim, including his examination of documents furnished by Merrill-Stevens: "None of this data is shown in the record, but the examination of it was reported to the court by the trustee and his counsel (II 25)" (T.Br. 34). Similarly, the trustee's off-the-record statement attempt-

ing to excuse his failure to acquire new-design vessels to replace the obsolete LSTs: "The major financing required to replace them cannot be had while the trusteeship exists; the Department of Commerce has approved as feasible the guarantee of a large loan for this purpose, but will not consider it as long as the plan of reorganization is under attack in the courts" (T.Br.64), is more of the same. Likewise his purported excerpt from an SEC report of a navy chemical engineer's examination of Coast Guard records of unstated scope is not alone hearsay at least four times removed but illustrates the vice of off-the-record investigation and compromise based thereon, of which we have complained with detailed case law citation (C.Br.24,33ff.). Perhaps the most gross example in the ten-year history of this reorganization, of the unreliability of such unsworn and off-the-record investigation, is that of a Department of Justice attorney for the Government in its capacity as creditor, resulting in his enthusiastic accolade of Shaffer-Spitzer, quoted S-SBr.9-10.

As set out in our brief, when the trustee did get around later to making Shaffer-Spitzer subject of a real § 167 investigation under oath and with the right of examination of all parties (C.Br.8-9) the trustee found unmistakable proof of the very matter that the Department of Justice admiralty lawyer looked for but failed to find:

(1) That the real principals of the Shaffer-Spitzer mortgage were Shaffer himself, and Abrams, the prime wreckers of the company (I 272-291);

(2) That Abrams and Shaffer as financial advisors exercised a high degree of control over the affairs of company (I 262ff.,288);

(3) That the mortgage itself was an unfair and fraudulent transaction (I 282-286).

At least one cause of action against management was also established contrary to the Department of Justice man's anticipation (T.Br.7).

In spite of this horrid example, the trustee now tells the Court he made the same cozy type of investigation of Merrill-Stevens that so nearly allowed Shaffer-Spitzer to escape.

The point we have just made of the impropriety and unreliability of judicial reliance on information acquired off-the-record should hardly have needed pointing out to an experienced district court. Twice, however, the same district judge who had this case in charge has been reversed by the Fifth Circuit for basing decisions as he did here on information he believed he possessed, acquired off-the-record. One of these cases was a reorganization case, *Corr v. Flora Sun Corp.*, 317 F.2d 708: While the district judge's "subjective and independent knowledge * * * may have premised his judgment * * * the present record does not so reflect and is incapable of intelligent review in such regard" (at 710). Likewise in a case not yet reported he was reversed for importing into the record matters within his "extrajudicial knowledge" which are "not to be judicially noticed nor an ingredient in the determination of the litigation". *Fox v. West Palm Beach*, slip opinion p. 13, 5th circuit No. 23947, Sept. 26, 1967. Cf. *Sanders v. Beach*, 283 F.2d 946 (CA 10).

In this case too, on innumerable points, the court acted as an expert witness not subject to cross-examination (e.g. II 75, 76-7, 79, 80, 143, 160, 171, 310.27, 310.34, 310.45, 346.1, 915), and the trustee repeatedly relies on information allegedly given to the judge off-the-record but not given to the parties and never subject to adversary challenge.

The Trustee's Brief

The trustee's brief does not question certain fundamental points:

The trustee does not deny that public investors have been innocent victims of stock frauds by the cloaked owners of the Caplan mortgage.

The trustee does not deny the existence of a conflict of interest arising from his duties as a fiduciary and his expectation of continuing employment by the reorganized company.

The trustee does not deny that he made no on-the-record § 167 investigation of Merrill-Stevens.

The trustee does not deny that the Board of Directors that nominated him for president and will pass on his emoluments consists entirely of insiders: 2 patronage beneficiaries who were also discount buyers of claims, 2 representatives of Merrill-Stevens who is the beneficiary of his suppression of § 167 investigation, and the trustee's general manager and attorney.

The trustee does not deny that he and his insider allies blocked any cash plan.

The trustee does not deny that his and the district court's valuation of the debtor was solely based on past earnings.

The trustee does not deny that the stockholder claim to creditor treatment was never heard.

The trustee does not deny that the delay in reorganization, 1959 to 1965, was the result of his errors in 2 invalid plans later set aside as a result of appeals.

On these points, essentially undisputed, we feel the case turns. We are compelled however to reply to certain specifically misleading assertions:–

Trustee's brief, p. 7: the trustee's failure to assert certain causes of action: – The trustee, without citation to the paragraph of our brief that he criticizes, complains that we "imply that the trustee has not pursued causes of action against persons responsible for the mismanagement of TMT before the reorganization proceedings began. The truth is, as everyone involved well knows, that two suits were brought to recover damages against many of the persons responsible". He then points to a pending suit he brought against persons not including Shaffer, arising out of a Wilmington property

purchase, and to a suit he brought against Rath, ex-president of TMT, in which he has achieved judgment although no recovery.

In the passage in our brief in which we taxed him with so letting causes of action lapse, we conceded he had brought that very Wilmington suit (C.Br.30). But he never followed through on his own 1960 recommendation for suits and counterclaims against Shaffer, Abrams, Erdman, et al. on the Bellanca stock swap deal and several quite other instances of diversion of corporate opportunity and of private profit from sales of company stock (I 263-4, 286, 289, 291, 294). More important, our briefing there was directed to his treatment of the Shaffer-Spitzer mortgage, viz. his failure to assert these causes of action against mortgage participants either by way of counterclaim against the mortgage or by way of separate suits; and worse, that for three years he hid the fact that stifling those causes of action was covert part of the 1962 Plan II "compromise" with Shaffer-Spitzer (C. Br.30). This he has not answered.

We note infra, p. 15, in response to Shaffer-Spitzer's assertion that there was a full disclosure as to them (S-SBr.9 ff.), the later unmasking that the plan included boot to Shaffer's wife who had been privy to his deals, by way of allowance of her hidden $115,000.00 debenture creditor claim.

Trustee's brief, p 20: "Law of the Case": The Court of Appeals on the third appeal repudiated the trustee's broad "law of the case" contention, 364 F.2d 936, 938-9. The trustee still urges, however, the Fifth Circuit's rejection on the second appeal of the contention that the trustee was disqualified as a matter of law, as precluding us from contending that the plan is invalidated because promulgated by a trustee who had put his independence in pawn through conflict of interest. The trustee's argument ignores the express proviso of the Fifth Circuit's opinion that it did not preclude disqualification in fact on a specific showing. Since we continued to assert the existence of such disqualification

in fact, and renewed it on the remand in the precise terms of the Court of Appeals reservation of the issue, we were on no possible construction barred by "law of the case." Moreover, as we pointed out in our Petition for Certiorari p. 14, the remand of Plan II by the Fifth Circuit deprived the advisory ruling of finality, since a new Plan III which the Court of Appeals itself anticipated might be developed, 334 F.2d 118, 119, might well have made the question moot. This is also the thrust of the cases cited in the SEC's Brief p. 23, which the trustee has not mentioned or answered at all.

Trustee's brief p. 20-21: – purported failure of the stockholders committee to object to the new management: – The trustee points out, for once with record citation, III 351 ff. that when the board of directors came up for court approval on confirmation of Plan III there were no objections "*even from counsel for the Stockholders Committee* who was present" (trustee's emph.). He omits to report that committee counsel had just been peremptorily gagged. On the very page before, the record reads:

> "THE COURT: By the way, Mr. Trustee, prepare a rescission of the order authorizing him to represent a Stockholders' Committee – and to get rid of that right now.
>
> MR. LANGBEIN: Is that order effective immediately, your Honor?
>
> THE COURT: Immediately."
>
> MR. LANGBEIN: The Court no longer wishes to hear me in these proceedings?
>
> THE COURT: * * * Your authority will be rescinded." (III 350-1)

At that, no one in the case could doubt our position, of vehement objection to a board comprised of the trustee and his pals. Our Plan II appeal had raised the point, and when Plan III was promulgated we had raised it again in a formal pleading (III 244-5).

Trustee's brief, p. 28: the need for investigation of new management: – The trustee asserts that we made an "unwarranted assumption * * * of improper affiliations" when we asserted C.Br.36ff, the need for § 221(5) investigation of new management's affiliations, for he says there was nothing about new management to investigate, since it was either all spread on the record or known to all off-the-record. For our criticism of the trustee's substitution of off-the-record for on-the-record, see supra p. 2. Investigation necessary to comply with § 221(5), however, covers not merely the fact of affiliations but the "good faith" of the plan and whether the appointments are "consistent with public policy". This we elaborated, C.Br.38-9, in terms of the propriety of investigating the egregious bank loan discussed C. Br.54, to say nothing of the need for weighing against the quoted statutory tests a new management that included patronage beneficiaries whose purchase of claims protected their patronage, and persons under unrebutted charges of pre-reorganization fraud.

Trustee's brief p. 29: "no appeal has been taken" from the towing contract: – Not so. Notice of Appeal from Order Approving Renewal of Towing Contract, III 212; Statement of Points on Appeal III 382.

Trustee's brief p. 36: defenses against Merrill-Stevens:– "All the issues concerned [Merrill-Stevens] tort liability for results of its work and whether some of the work could properly give rise to maritime liens against the vessels". Not so. Contract defenses were asserted and more importantly, unanswered charges of collusion with TMT, Abrams and Shaffer, to defraud Maritime Administration and public investors (II 362, 367, 1046,1066-7,1072.1-.4,1077; III 18; see also during-reorganization fraud I 236), summarized principally at C Br 26. In addition to the charges we made and specified and for which the trustee's own report laid substantial foundation (I 261,271), we sought by discovery proceedings to obtain for the record further documentary proof of these matters, which we had located and identified. The trustee had admittedly never seen these documents but discovery was actively and successfully opposed by him, C Br 26-7.

Trustee's brief p 49: cash bids and solvency: – The Trustee says that to compare the cash offer with the insolvency finding of value, it is necessary to subtract the the current liabilities because they would have to be paid out of the cash bid. This is wrong. Current liabilities would have to be paid in any case. The court's valuation of $2,780,000.00, since it purported to be a going concern value, had to be a valuation before (not after) provision for payment of current liabilities, and hence exactly comparable with the cash bid.

Moreover and more important, the trustee misses our point that the cash bids never reached their maximum. (C.Br.45ff.). Both the bidders expressly stated that they had not reached their maximum. Instead of urging new bidders to enter the lists or even those cash bidders to give their top figure, the trustee warned that no cash bid would be accepted by major creditors. The effect of this, of course, was to knock in the head any impulse for bidders to bid. We do not know how high they would have gone. We do know that in a very short space of time they have jumped by small steps from $1,600,000.00 to $2,800,000.00 and had not reached the top. (ibid.).

The well-advertised refusal of major creditors to take *any* cash bid shows, of course, that their own valuation of the enterprise was much higher than the derisory figure put on it by the court. This is strongly reinforced by the fact that creditors who were entitled under the plan to get 100 cents on the dollar elected of their own free choice to take stock (II 878, 879.3, 987; III 91, 94). What this proves is either that the acceptances of the plan were not in good faith (as we assert); or that the real value of the enterprise was more than 100 cents on the dollar of creditors claim - i.e., that it was solvent (as we also assert); or both.

Trustee's brief p.50: the creditors committee's purported adverse report on the cash plan: – In defense of his assertion that cash bids did not supply a realistic alternative to the court's valuation in the alternate "internal" plan, the

trustee says: "The Creditors Committee had reported that it would not recommend a cash plan that did not provide for a maximum payment of at least 50¢ on the dollar for the unsecured creditors (II 652)" Not quite. The creditors committee's criticisms applied equally to either plan and was stated before either plan was formulated: "As a Creditors Committee, we do not feel that we could recommend any plan to the Court which did not provide for a minimum payment of at least fifty (50) cents on the dollar, *either* in cash, cash and securities or securities, which would be acceptable to the unsecured creditors." (II. 652, our emph.) It was rather the trustee's allies, the insider creditors, that rejected the cash plan, citations collected C.Br.47.

Trustee's brief, p. 53-4: 1961 tender of "Statement of Position": – The trustee says that the record contains "nothing to indicate that the (stockholders' creditor-claim) issue was ever brought to the attention of the court or any interested party in 1961, as Petitioner contends." Our Statement of Position (II, 1037) explicitly advancing this claim was served in March 1961. Although then rejected by the court, it was later filed nunc pro tunc by leave of court. Printed in the appendix infra, at A 2-7, are extracts from the district court record on the point: our service certificate dated March 24, 1961, showing service of our "Statement of Position"; also the 1963 Rule 60(a) petition to complete the record of 1961 tender, and the 1963 colloquy in open court in which the district judge, granting our petition, recited his recollection of the tender, precisely as stated C. Br. 14 n. 17. Certified photocopies of the original district court documents have been lodged here with the Clerk. Between the 1961 tender and 1963 formal filing, it was expressly referred to in June 1962 without contradiction as having been tendered "over a year ago" (II 367-8).

Trustee's brief, p. 62: class action:– The trustee says, "this is not the kind of class action permitted".– In the securities field, well-considered cases and the Advisory Committee on the Rules recognize that "a fraud perpetrated on numerous persons by the use of similar misrepresentations," as we charge is the case here, "may be an appealing situation for class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class." Advisory Committee's Note to new Rule 23. *Fischer v. Kletz*, 41 F.R.D. 377 (S.D.N.Y., 1966); *Oppenheimer v. F. J. Young & Co.*, 144 F.2d 387, 390 (CA 2, 1944).

We do not advance our claim as a class action under Rule 23, however, for our position is stronger. An essential feature of Chapter X is the protection by representative committees of the interests of scattered small security holders. 2 SEC, *Report on the Study and Investigation of . . . Reorganization Committees* 1-7, 495-7, 502-3 (1937). The technique of settling in principle the complex issues affecting alike all the public stockholders who bought in the manipulated market, by a representative claim (subject to proving up the damages claimable by individual victims after the principle is settled) reflects precisely one of the basic purposes of Chapter X.

Trustee's Brief Appendix A1-2: the trustee's budget of alleged inaccuracies:–

No.1 On the essential soundness and profitability of the company (C Br 5), see the trustee's own statement of this and of the reasons for the debacle which do not go to the essential soundness of the enterprise (I 260,271). Cf. the earnings reported even under retrenched reorganization conditions, Tr Br 44, downwardly distorted at that, C Br 47-50.

No.2 On stock options (C Br 5,62), the trustee does not deny the basic point that three successive plans he presented made him president and director with explicit or, later, implicit assurance of a long-term contract to be obtained from his beneficiaries. His denial that these deals included as icing on the cake explicit or, later, implicit assurances of substantial stock options will not stand in the face of the record citations in CBr 8,13, to which we add III 255; cf. 352-354, 52-53, 93, 197.

No. 3 On Committee charges of fraud against Merrill-Stevens, see our comment on TrBr 36, supra, p. 8.

No.4 On the locus of control, see record citations at C Br 8,12,25, 36-39.

No.5 As to Merrill-Stevens control, see No. 4 above. As to the thoroughness of his investigation of Merrill-Stevens, see the trustee's failure to permit discovery procedures to bring into the record incriminating documents we had located and identified and that he admitted he had never seen, citations at CBr 26. As to the proof of fraud against Shaffer-Spitzer, see his own explicit conclusions from the investigation so reluctantly undertaken, in which he took 2200 pages of testimony and 60 exhibits from 33 witnesses and concluded that the Caplan (Shaffer-Spitzer) mortgage was a fraudulent transfer (I 282) and that numerous actionable frauds were perpetrated by its principals (I 290,291, 291-2). As to Shaffer-Spitzer's concealment of their relation to Abrams, see the affidavits by Messrs Shaffer and Caplan (I 173-9) and the direct denial by Mr. Spitzer in

open court, infra App p 1, original lodged with the Clerk; and see the trustee's conclusions of misrepresentation to the court on this and other points (I 274-281, 288-9).

No.6 See No. 3 above. The allegation that Merrill Stevens was involved in the marketrigging is not an allegation that they sold stock in rigged market: they helped others to do so and it is immaterial whether they themselves did so.

The Shaffer-Spitzer Brief.

Shaffer-Spitzer present themselves and their predecessor Caplan as indenture trustees for "a group of plainly disclosed investors" (S-S Br 5) who have been amply investigated and have turned their pockets inside out (S-S Br 9 ff). Bluntly, this picture is a hoax.

Our principal brief did not anticipate an active appearance at this stage by Shaffer-Spitzer who filed no brief in the Court of Appeals and did not oppose certiorari. Since we did not anticipate their presence, our main brief deals more summarily with matters concerning them than is appropriate in the face of their broad denial of facts we detailed and their detailed recital and misrepresentation of facts out of context that serve only to distract.

The identities of the Shaffer-Spitzer group were elaborately hidden under several layers of cloaking. The real principals were Abrams, Shaffer, Erdman. They are identified in CBr 7 n.2,3,4. The instruments, however, did not name Abrams nor Shaffer nor Erdman (I 274; the text is set out at pp 23-53 of the record of the Fifth Circuit No. 17117 which was incorporated by stipulation in the present record and has been lodged with the Clerk). Caplan, the original trustee "at all times was a front for Shaffer" (I 275). Abrams' interest was hidden in part behind Gordon and in part under a corporate name, Bostwick Westbury (I 259, 276,277) and these interests were in turn hidden behind Kahn and Russo, Russo in turn behind Schwerin like a game of three card monte (I 277-8). Erdman's interests were hidden behind still other names (I 276).

The mortgage was itself a market-operator's fraud. This group, elaborately masked, were the financial advisors of the company, insiders who dominated the company to its harm, caused it to issue to them over 1,800,000 shares of stock illegally and float it fraudulently to the public at hundreds of thousands of dollars of profit to themselves (I 262,281, 286-291; II 1092) and rendered the company by their abuse incapable of obtaining financing from respectable sources (I 289) so that when it needed money (as a result of the Carib Queen explosion) on what insiders knew was the brink of bankruptcy (I 286) it could obtain it only from them.

The deal masqueraded as a mortgage just as the insiders masqueraded under front names as investors. In fact it was a market manipulation and a bankruptcy manipulation, that furnished short-term money for a long term need at grossly exorbitant terms, with a conversion privilege for equity profits in case of rescue but a mortgage form (on the only remaining working assets) to dominate the reorganization, if as seemed likely and as proved to be the case, there was to be one (I 273, 284-290). This is a classic manoeuvre, I SEC, *Report on the Study and Investigation of . . . Reorganization Committees* 160. This mortgage, the trustee correctly characterized as an abuse of fiduciary power (I 286-290).

Full relevant disclosure has still not been made. Not until a § 167 investigation made by the trustee with the aid of the SEC's expertise about stock manipulation were any of the facts brought home which lay behind misleading affidavits by Caplan and Shaffer (I 173-9) and a denial by Spitzer in open court (infra, App. 1) that Abrams, Shaffer and Erdman are the real principals as well as the history of their domination and exploitation of TMT by stock manipulation and their defrauding of public stockholders.

The trustee had to be goaded by our appeal and by the SEC's staff affidavits of corroboration before he would go beyond his friendly confidence in this group of experienced

confidence men. His investigation is not yet complete—he has still declined to investigate Merrill-Stevens' involvement in the same conspiracy, supra p. 8. As far as it went, however, it demonstrated misrepresentation of the identity of the principals, and their involvement in fiduciary abuses culminating in the mortgage.

Investigation of the facts is not enough. The trustee himself proposed appropriate remedies demanded by the equities: set-offs for profits made by the principals, suits against the principals (for the Wilmington fraud, but also for the Bellanca fraud and others), creditor treatment for the stockholders and disallowance of the mortgage claim or at least subordination to the stockholders as creditors by reason of the frauds. These are the trustee's recommendations (I 282, 286, 289,290,291,294; II 1092,1096). None of this has happened (except the Wilmington suit still pending). CBr 30-32,56.

There has never been the disclosure, required by the case law (CBr 32-6) of reasons why, after recommending these remedies on a carefully built record, the trustee once again has surrendered and gives the Shaffer-Spitzer group priority treatment over the defrauded creditors and other innocent general creditors.

As to the set-offs and suits, the situation is worse. Not only was there a failure to disclose reasons for not bringing the suits and for not asserting the set-offs, the trustee failed to disclose on the record to the stockholders or creditors or SEC that a secret understanding was actually made in 1962 to suppress the suits and waive the set-offs. This was disclosed as to the suits for the first time in 1965 (III 192; CBr 30) and as to set-offs in 1966, after the start of the present appeal, when a debenture claim of Shaffer's wife, Pauline Golding was recommended for allowance on the express ground of this concealed agreement.

The disclosure that such abandonment of defenses against claims by individual Shaffer-Spitzer people was also "settled in the plan of reorganization" (III,192) took place in a

district court pleading filed by the trustee stating as reason for not defending against the Golding claim:

> "It was *determined by the trustee, and approved by this court,* in 1962 when the present Internal Plan of Reorganization was being considered, approved, accepted by the creditors, and confirmed that there would be *no actions brought* against Arthur Shaffer or Pauline Golding and certain others as a result of apparent irregularities that may have occurred in the issuance of TMT stock" (Our emph.)

The record documents on this disclosure appear infra, App. A 7 ff., certified originals lodged here with the Clerk.

Shaffer-Spitzer, in concluding their brief, assert the standard case law that set-offs against cestuis are not available against the mortgage itself. But this cited case law (S-S Br p. 32-3) deals with innocent cestuis, carefully distinguished in the very passage they quoted from *Dickerman v. Northern Trust Co.*, 176 U.S. 181, "so far at least as they were innocent holders". It can have no application to conspirators for whom the indenture trustee is a tool as the reorganization trustee found here.

Thirty years ago the SEC, in the monumental report that led to the procedural reforms embodied in Chapter X, pointed out how easy it is for those who dominate a bad reorganization to make it look good enough for a trusting court to approve:

> "Outwardly reorganizations may appear to be expeditious, economical, fair, and honest. Often, how-

ever, those characteristics will only be illusions. Reorganizers will merely have dressed the procedure in familiar and respectable garb", Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees,* Part I, p5 (1937).

Respectfully submitted,

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November 6, 1967